

# CONTRACTOR

March > April 2011

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**Plus!**

Construction Success Story  
Contractor seeks to prevail  
over prevailing wage confusion

## Don't get tangled in the web

Sales and use tax rules  
can snare the unaware



**Smith & Gesteland<sub>LLP</sub>**

Certified Public Accountants & Business Consultants

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8383 Greenway Blvd., Suite 400 • PO Box 1764 • Madison, WI 53701-1764  
Phone 608.836.7500 • Fax 608.836.7505  
mail@sgcpa.com • www.sgcpa.com

# Don't get tangled in the web

## Sales and use tax rules can snare the unaware

**P**aying taxes is never fun. For contractors who cross state lines, however, it can be a particularly confusing process. Sales and use taxes for construction projects differ from state to state, and states require companies to track what they owe. Perhaps it's enough to make you ignore the issue entirely and let the chips fall where they may when it comes to settling up with state tax authorities.

That's probably not a good idea. With states searching for extra revenue to plug their growing budget gaps, some are enforcing their sales and use tax rules more strictly than ever. So it's critical to get and stay up-to-date on sales and use taxes to avoid getting tangled in the web so often spun by out-of-state jobs.

### Review the basics

Contractors generally owe sales tax. It's paid to an item's seller at the time of purchase, for the cost of materials, supplies, equipment and services that are bought, rented or used on a job.



This is because states consider materials used in construction to be tangible personal property, which is taxable, and the contractor to be the final user who converts that tangible property into real property.

Sales and use taxes aren't cumulative; if you pay use tax on an item, you generally can get your sales tax back for it.

In contrast, contractors typically don't charge sales tax on completed projects because some states consider a completed building or renovation to be nontaxable real property, not tangible personal property. If you provide real estate repairs or maintenance services, however, some states may require you to collect sales tax from customers for materials and parts, because

those repairs may be considered tangible personal property and taxable.

If you charge sales tax for materials used in your services, some states require a seller's permit. Check into whether this prerequisite may apply to any out-of-state job you're considering.

### Be consistent

Contractors may have to pay use taxes directly to the government when buying equipment or materials from an out-of-state vendor that isn't required to charge sales tax or that charges a lower sales tax. Sometimes

### 3 tips for easing your sales and use tax burden

**1. Design your invoices in a way that reduces the taxable part of a purchase.** For example, some states don't tax delivery charges when they're invoiced separately from other taxable charges. Reach out to your suppliers and ask them how they handle sales and use taxes and whether they might have some advice for you.

**2. Retain resale or exemption certificates.** These allow you to avoid paying or charging sales or use tax on related purchases. If you're audited and haven't paid taxes for some transactions, you'll need to prove you weren't required to do so.

**3. Ask your tax advisor to double-check your work.** He or she can point out possible exemptions you may have missed out on. Some states, for instance, will provide refunds for up to four years after a qualifying purchase. Your tax advisor may also be able to assist you in determining how to account for sales and use tax liability in your bids.



use taxes come up for contractors when crossing state lines for a construction project as well.

Like sales taxes, use taxes are generally due on any materials or supplies used on the job. If you pay sales tax on an item and the item is used in a project elsewhere, you're still responsible for paying use tax but you may be entitled to a credit for the amount of the original sales tax paid.

Sales and use taxes aren't cumulative, though. So if you pay use tax on an item, you generally can get your sales tax back for it. Say you buy drywall materials in State A and use them on a job site in State B. In this case, you'd have to pay State B's use tax, but you'd generally receive a credit for the sales tax you already paid in State A on the items.

Contractors are responsible for calculating and submitting their use taxes to the right place, so work with your tax advisor to make sure your numbers are accurate and your documentation is going to the proper parties.

#### Know your exemptions

Sales and use tax exemptions can translate into huge savings for you. One that every contractor should look for is the exemption for government or nonprofit work.

States can't impose taxes on the federal government, and some states allow exemptions for themselves, local municipalities and nonprofit organizations. Contractors who act as agents for government agencies or nonprofit organizations can often be exempt from sales and use taxes on their projects' materials and supplies. The definition of "agency" is specific in most cases and not all states allow an exemption for an agent, so check into this matter before you bid.

In addition, some states offer exemptions on other types of purchases, such as items destined for inventory and capital equipment. Your CPA can help you identify these exemption opportunities.

#### Stay on top

Staying on top of your tax responsibilities remains a critical way of ensuring that any job you undertake is as profitable as it can be. That said, sales and use taxes are an extremely complex area, and this article only touches on some of the many issues that affect it and your specific liability on any given project. Consult with a tax advisor who knows the sales and use tax laws in the states where you operate to ensure you're fulfilling your obligations yet not paying more than is required. ■

# Cash in if you can on the extended tax carryback

**T**he Small Business Jobs Act (SBJA), enacted last year, contains a prime tax-saving opportunity for contractors. An SBJA provision includes an extended five-year “carryback” for general business tax credits to offset both regular tax liability and alternative minimum tax (AMT) liability. The provision applies to sole proprietorships, partnerships and nonpublicly traded corporations that have \$50 million or less in average annual gross receipts over the three preceding tax years.

## An outdated system

A carryback is essentially a function of the tax code that allows you to apply an unused tax credit for a certain year to a tax liability from a previous year. (An election needs to be filed to identify years of the carryback.) Some of the business credits available to contractors include those for building energy-efficient homes and using green fuels in their fleets, as well as credits for providing health insurance to employees and hiring workers from certain disadvantaged groups.

Along with letting you apply unused tax credits to up to five years of previous returns, the SBJA allows you to apply business credits for the first time to AMT liability.

But under the old laws for the general business credit (a broad category comprising a variety of business-related tax credits), contractors often



couldn't use the credits for which they qualified. The general business credit set a cap on the total amount of credits a business could collect, limiting the overall credit amount to a company's net income tax less either 25% of its tax liability beyond the first \$25,000 in taxes or its AMT payment, whichever was greater.

For the credits that invariably went unused, the IRS gave businesses a one-year carryback, allowing them to apply the credits to their previous year's liability, as well as a 20-year carryforward on future tax liabilities.

## Welcome relief

With new construction slowing and profits dwindling in recent years, however, a one-year carryback didn't provide the immediate tax

relief that many contractors needed. So, thankfully, the SBJA introduced an extended *five-year* carryback. Along with letting you apply unused tax credits to up to five years of previous tax returns, the new law also allows you to apply business credits for the first time to any AMT liability you incur.

The five-year carryback applies only to credits earned in a fiscal year that began after Dec. 31, 2009. So if your construction business doesn't

operate on a calendar year, you can use only the business credits that you accrued once your new fiscal year began in 2010.

#### Critical dollars

Work with your CPA to determine whether you're eligible for a carryback. Also ask him or her about the recently passed Tax Relief act, which extended many existing tax law provisions. ■

## Tripping out of the gate

### 4 bidding mistakes to avoid

**C**onstruction markets in most regions remain very competitive. That means you've got to be at the top of your game throughout the building process. There are, of course, many places where a construction business could stumble during a long project, but one of the worst has to be at the very beginning — during bidding.

A misstep here could only be described as "tripping out of the gate." Let's look at four bidding mistakes to avoid and some ways to ensure you submit the best offer for both the job in question and your construction company.

#### 1. Overlooking indirect costs

Like most contractors, you're probably pretty good at identifying direct costs. Yet one problem that scuttles many bids is focusing solely on these amounts and ignoring or miscalculating indirect costs — those not directly attributable to the project at hand but still likely to be in play.

One example is the equipment you own. If you've fully paid off a piece of equipment, you may not see any current cash outflows

associated with it. But if you're not allocating an expense for the equipment, you may not be recovering costs on depreciation, repairs, property taxes, storage and insurance. You need to include all of these costs in a bid.





## 2. Undervaluing profitability

With jobs still in such short supply, it's understandably tempting to jump at every one that comes along regardless of whether it will actually earn you a profit. That said, calculating profit margin is always tricky. Once the numbers start flying, it's important to keep your wits and not end up undercutting your own profitability.

Say you'd like to bid on an \$800,000 job. If the average gross profit that you strive for on your jobs is 20%, then estimated costs for the job can't exceed \$640,000. To arrive at this figure, take the sales price and multiply by your 20% profit goal ( $\$800,000 \times 20\%$ ). This will give you a \$160,000 gross profit. Then subtract that gross profit from the project value ( $\$800,000 - \$160,000$ ) and the result (\$640,000) is the total estimated costs you'll need to hit to meet your 20% gross profit margin.

## 3. Lagging behind technologically

Although technology has its dangers, it can sharpen your competitive edge. For example, where do bids begin? With estimates. And how can you improve your estimates? By upgrading your technology.

Today's estimating software now offers 3-D capabilities that allow estimators to see their work from all angles and in vastly more detail

than they could with previous software. For instance, an estimator can separate construction components from the overall structure to scrutinize them individually.

Of course, these applications come with substantial purchase and implementation costs. And you'll likely need to provide training on the software for your estimators. But the benefits are there for the taking.

## 4. Ignoring the "other guys"

Don't make the mistake of underestimating your competition. When working on a bid, it's easy to be self-focused. After all, you're assessing your company's capabilities in light of the demands of a project to determine how much you should charge.

But the nature of the competition can seriously affect your bid. If two of your main competitors are notorious for bidding low, you may have to reduce your bid comparatively. Is the job still worth it? This is another good reason to be aware of who's working in the same markets as you are.

Once the numbers start flying, it's important to keep your wits and not end up undercutting your own profitability.


## Science meets art

Some contractors might say that bidding is a science — you crunch the numbers and stick to them. Others might say that it's an art — when your gut says a project will be profitable and elevate your visibility in the marketplace, go for it.

The truth probably lies somewhere in between. Now more than ever, you've got to do the math and make sure your cash flow can handle the burden of every job. But, at the same time, no one knows your local market and construction company like you do. So your gut certainly deserves a say. ■

## Construction Success Story

### Contractor seeks to prevail over prevailing wage confusion



For one road renovation contractor, opportunities for private construction jobs were scarce. So when his state announced a federally funded bridge renovation on a major highway, he was eager to submit a bid.

The catch? The contractor hadn't worked on public projects before, so he needed some advice on navigating the confusing prevailing wage laws. He contacted his financial advisor to learn how to comply with the requirements and still keep his costs down.

#### Doing the research

His advisor began by explaining that the Davis-Bacon Act requires construction companies to pay workers on federally funded projects "prevailing wages," which are set by U.S. Department of Labor surveys and include a wage and a separate benefit payment. The contractor's state, like many others, had a separate prevailing wage law as well.

From there, the advisor did some quick research into the state and federal prevailing wage laws that applied to the job in question. For federally assisted state or local construction projects where the state and federal prevailing wages differ, he warned, the construction company generally pays the higher rate for both wages and benefits. Indeed, it appeared the contractor would likely have to pay \$20 an hour and an additional \$8 per hour in benefits for his 10 workers.

#### Paying the freight

Next, the two discussed the best way to pay for benefits if the contractor won the job. The contractor didn't have a formal benefit plan for his workers, so he thought it would be easier to include benefit payments in his employees' paychecks.

The advisor cautioned that lumping benefits in with the rest of his employees' wages meant the contractor would have to pay taxes on the benefits — possibly tacking on up to 30% in extra costs. As an alternative, the advisor recommended creating a tax-exempt "bona fide" benefit plan. Based on the contractor's workers' hourly benefit rate, such a plan could save his company substantial tax dollars during the project.

Finally, the advisor suggested that the contractor upgrade his generic accounting software to a construction-specific application that could track employees by job, trade and hour; generate certified payroll reports and historical reports; and pay benefits through a qualified plan. The software could help prevent the contractor from violating reporting standards and falling prey to costly fines for missed deadlines.

#### Cementing a reputation

Armed with that information, the contractor completed a competitive proposal and snagged the bridge project. From there, and with his advisor's help during the job, the contractor met his paperwork filing deadlines, remained on budget and cemented his construction company's reputation for dependability with state officials.



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As specialists in the construction industry, Smith & Gesteland has developed the expertise needed to help contractors address and meet their many challenges. We would welcome the opportunity to help you build your success.

To find out what we can do for you, or for more information about the ideas presented in this newsletter, please contact John Folsom or Steve Pullara at (608) 836-7500 or [mail@sgcpa.com](mailto:mail@sgcpa.com). We look forward to talking with you.